Summer 2012 **ASTBERRYS** Newsletter

We are letting and managing agents for individual flats and blocks of flats in Kensington and Chelsea. We will also let to you our own properties. We carry out all building works, refurbishment and maintenance of flats and blocks. We offer in-house legal advice on all aspects of the letting business and property law. We also carry out valuations and property sales.

We are members of the Association of Residential Letting Agents, and we are authorised as an appointed representative by the FSA to conduct insurance mediation activities.

Our regular Newsletter covers areas of interest concerning the management and legal aspects of property, the sales and letting markets.

PROPERTY YIELDS, INVESTMENTS AND THE EURO CRISIS

What are rental yields and why are they important?

The phenomenal price increases in Kensington and Chelsea over the last 5 years, around 42 % on average, have had an interesting effect on rental yields. As prices have risen, even allowing for a steep rise in rents, the yield has dropped. The yield is the ratio of rental income to capital value. For example, a property worth £500,000 producing a rental income of £25,000 p.a. has a rental yield of 5%. Assuming no change in capital value, if the same property rents out at £50,000 p.a. the yield rises to 10% and conversely if rents were to drop by half then the yield would drop to 2.5%.

Yields are an important tool by which investors can gauge a reasonable return on their capital invested in one asset class as opposed to another. Generally speaking, the greater the risk attached to the asset the higher the yield the market will demand for buying it. For example, if you purchase UK government debt in the form of gilts then the yield is low, around 1.6% for a10 year gilt. This is because you do not have to carry out any work for that yield and the investment is regarded as being very secure. The UK government is not expected to default on paying interest to the holders of gilts. By contrast, Greek government debt attracts a far higher yield because the market perceives the risks associated with buying it as high.

The same basic rules apply to property purchased as an investment. If you purchase property then the market expects a higher yield over that offered by gilts to reflect the work and risk involved in letting and owning property.

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Studio flat – Queens Gate, SW7

Let in July 2012 by Astberrys at £315 pw
Size: 345 ft^2
Yield 4.4%

Come and talk to us about maximising yields in Kensington and Chelsea. We have real expertise in sourcing, letting and managing investment properties.

Contact us at business@astberrys.co.uk or telephone 0207 370 0123.

1 bedroom flat - Penywern Rd SW5

Let in July 2012 by Astberrys at £325pw
Size: 390 ft ^{2}
Yield 4.5%

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Within the field of property investment the same elements of risk and work also apply. The greater the risk and work attached to the property the greater the yield demanded by the market. The yield on letting a tired flat to four sharers is generally higher than the yield on letting a luxury flat to a corporate tenant. One of the reasons for this is because the risk of default is higher. If a landlord lets rooms or runs an HMO the work involved is greater than in the case of a letting to one individual or family. Again, you would normally expect the rental yield to reflect this.

Expected capital growth is another feature which causes people to pay more for property in one area than another, even though the rental yield per pound spent is smaller. The average rental yield in Wales at 7.7% is higher than the overall rental yield in London at 5.7%. The overall rental yield in prime London locations, which include Kensington and Chelsea is lower still at just under 3% for houses and around 3.75% for all types of flats. However, even though the rental yield may be lower in the best areas, capital growth is higher. No area outside the London prime market has seen a growth rate of 40% plus over the last 5 years.

How do yields work within Kensington and Chelsea?

Rule 1 - Small is beautiful

The smaller the unit the higher the yield. This is because "entry level" rents are high per square foot in Kensington and Chelsea for the minimum initial living space and then tail off the more space the tenant takes. For example, a studio of about 300 square feet in Kensington might let for around £340 per week, equivalent to £17,680 p.a. or £60 per square foot. A two bedroom flat of about 850 square feet in Kensington might let for around £730 per week, equivalent to £37,960 p.a. or £44 per square foot. A house in Kensington, although both larger in size and let at a higher rent will produce an even lower letting figure per square foot.

It follows that if you are looking for the best rental return from capital invested then you should purchase small units over larger ones.

Recent yield figures for three areas of Kensington and Chelsea appear below

It is notable, that the highest rental yield is to be had from studio flats in Earls Court. With the exception of luxury flats in Knightsbridge, within each of the three sample areas above, the yield drops as the size of the property increases. As a rule of thumb this is true about all other areas within Kensington and Chelsea and prime London property generally.

Studios

Area	Average sale price in £ paid in the first six months of 2012	Average weekly rent in £ for the first six months of 2012	Yield in %
Earls Court	301,000	300, based on the 12 months to December 2011	5.2
South Kensington	514,000	339	3.4
Knightsbridge	700,000, estimated figure. Data not available	418 , based on the 12 months to December 2011	3.1

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One bedroom flats

Area	Average sale price in £ paid in the first six months of 2012	Average weekly rent in £ for the first six months of 2012	Yield in %
Earls Court	611,000	426	3.6
South Kensington	778,000	503	3.4
Knightsbridge	1.1 M	650	2.4

Two bedroom flats

Area	Average sale price in £ paid in the first six months of 2012	Average weekly rent in £ for the first six months of 2012	Yield in %
Earls Court	980,000	654	3.4
South Kensington	1.19 M	733	3.2
Knightsbridge	2.19 M	1087	2.5

Three bedroom flats

Area	Average sale price in £ paid in the first six months of 2012	Average weekly rent in £ for the first six months of 2012	Yield in %
Earls Court	2.2M	1283	3.0
South Kensington	2.6 M	1557	3.1
Knightsbridge	4.6 M	2589	2.9

Rule 2 - Ugly can be beautiful

The second general rule is that the worse the area the higher the yield comparing like with like. The yield on a one bedroom flat is better in Earls Court than South Kensington and both areas offer around a 40% better yield than the equivalent property in Knightsbridge. It is only when you look at the largest properties that the yield varies little by area.

Rule 3 - The more flats you have the higher the rental yield

Paragon Mortgages have published statistics which show that nationally landlords with over 20 properties achieve an average yield of 7.7% whereas those with one property achieve a yield of 4.9%. Our experience suggests that, this trend is equally true in Kensington and Chelsea. **Professional landlords enjoy economies of scale and often own all the flats in any one block.** This makes their investment easier to manage and ensures a constant high standard of presentation of both the individual flats and common parts of the building. This in turn, translates into higher rents, fewer voids and has a positive effect on the rental yield.

2 bedroom flat – Philbeach Gardens SW5

Let in June 2012 by Astberrys at £485 pw
Size: 819 ft^2
Yield 3.8%

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3 bedroom flat – Marloes Rd W8

Let in July 2012 by Astberrys at £740 pw
Size: 968 ft^2
Yield 3.6%

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THE CURRENT STATE OF THE SALES AND LETTINGS MARKET. WHAT IS GOING TO HAPPEN TO YIELDS?

Demand for property in the best parts of Kensington and Chelsea has been almost exclusively foreign lead over the last 2 years. Investment in the best properties in Kensington and Chelsea is still likely to be viewed as a "safe haven" for many years to come by investors from South East Asia, China, parts of the former USSR and southern continental Europe. The yield is not of prime concern to many of these purchasers. They are motivated by a desire for security and diversification. Once an owner has deducted the running costs and agents' fees of a two bedroom flat in Knightsbridge the gross yield of 2.5% will fall to nearer 1%. This is less than the rate of inflation and provides a lower yield than almost any other investment bar gold [which has no yield at all]. Of course, there is the hope of capital growth over time but few investors would be tempted by a real return of 1% p.a. for an investment which is neither risk nor work free. Will this trend continue? **Prices are beginning to stall and rents are falling**. This is hardly surprising bearing in mind that many investors have already purchased property in Kensington and Chelsea, the general global economic situation is poor and City bonuses are more restrained than in the past. If the euro fragments the consequential appreciation of sterling might make property even more expensive for European investors and global investment might find property in Paris or Rome a real bargain. **However, despite the pause and the risk of price falls we still think the demand for prime property in Kensington and Chelsea will continue. The very poor yield will have little effect on demand.**

In those parts of Kensington and Chelsea where investors are more concerned with yields the outcome may be different. In these areas, located predominantly in the western parts of the borough in postcodes SW5, SW10, W8 and W11 the effect of decreased rental demand is starting to be felt already. Depressed global activity and the euro crisis have produced less business for the City and hedge funds. Increases in levels of remuneration have slowed and hiring is down. Fresh redundancies are a possibility. As always in a downturn it is the two bedroom flats and larger units that are worst hit. We expect rents to fall by between 10 and 20% over the coming 24 months for such properties. The smaller units, especially if well presented, continue to rent well. This is because tenants located in such accommodation do not move. In our experience the average occupancy for a high quality one bedroom flat in W8 or SW5 is over 24 months and often over 36 months. The turnover in the bigger units is usually more frequent. In addition, some tenants are downsizing to reduce expenditure, but wish to remain in the same prime areas. Finally, those moving to London are not willing to commit to renting large units at a high rent, preferring smaller accommodation in the same areas. As rents drop it is quite possible that prices in these areas will come down and stay down. **If gross yields on a two bedroom flat in Kensington drop much below 2.5% then we would expect to see some owners cashing in on the substantial capital increase over the last four years. If they do so then the very low level of transactions, which has characterised the sales market for some time will change and prices will fall. If the Euro collapses and the City fares badly then the falls may be as high as 20%.**

ARLA Association of Residential Letting Agents

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The Property Ombudsman